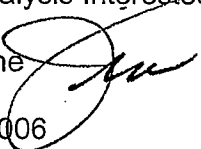




OFFICE OF
INSURANCE COMMISSIONER

MEMORANDUM

TO: Market Analysis Interested Parties

FROM: Jim Odiorne 

DATE: April 17, 2006

RE: Revised Z draft – 4/17 version

Attached are our proposed revisions to the original Z draft, based on our consideration of your comments on Sections 7, 8, and 9. We can consider further revisions to these sections in the future.

BILL REQUEST - CODE REVISER'S OFFICE

BILL REQ. #: Z-1101.1/06

ATTY/TYPIST: AI:ads

BRIEF DESCRIPTION: Establishing a program of market conduct surveillance within the office of the insurance commissioner.

DRAFT

AN ACT Relating to the establishment of a program of market conduct surveillance within the office of the insurance commissioner; adding a new chapter to Title 48 RCW; prescribing penalties; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** SHORT TITLE. This chapter may be known and cited as the market conduct surveillance law.

NEW SECTION. **Sec. 2.** PURPOSE AND LEGISLATIVE INTENT. The purpose of this chapter is to establish a framework for the commissioner's market conduct actions, including:

- (1) Processes and systems for identifying, assessing, and prioritizing market conduct problems that have a substantial adverse impact on consumers, policyholders, and claimants;
- (2) Market conduct actions by a commissioner to substantiate such market conduct problems and a means to remedy significant market conduct problems; and
- (3) Procedures to communicate and coordinate market conduct actions among state insurance regulators to foster the most efficient

NEW SECTION. **Sec. 3. SCOPE.** This chapter applies to all entities regulated by this title, and to all persons or entities acting as or holding themselves out as insurers in this state, unless otherwise exempted from the provisions of this title.

NEW SECTION. **Sec. 4. DEFINITIONS.** The definitions in this section apply throughout this chapter unless the context clearly requires otherwise.

(1) "Best practices organization" means insurance marketplace standards association or a similar generally recognized organization whose purpose and central mission is the promotion of high ethical standards in the insurance marketplace.

(2) "Commissioner" means the insurance commissioner of this state.

(3) "Complaint" means a written or documented oral communication primarily expressing a grievance, meaning an expression of dissatisfaction.

(4) "Insurer" means every person engaged in the business of making contracts of insurance and includes every such entity regardless of name which is regulated by this title. For purposes of this chapter, health care service contractors defined in chapter 48.44 RCW, health maintenance organizations defined in chapter 48.46 RCW, fraternal benefit societies defined in chapter 48.36A RCW, and self-funded multiple employer welfare arrangements defined in chapter 48.125 RCW are defined as insurers.

(5) "Market analysis" means a process whereby market regulation personnel collect and analyze information from filed schedules, surveys, required reports, and other sources in order to develop a baseline understanding of the marketplace and to identify patterns or practices of insurers that deviate significantly from the norm or that may pose a potential risk to the insurance consumer.

(6) "Market conduct action" means any of the full range of activities that the commissioner may initiate to assess and address the market conduct practices of insurers, admitted to do business in this state, and entities operating illegally in this state, beginning with market analysis and extending to examinations. The commissioner's activities to resolve an individual consumer complaint

or other report of a specific instance of misconduct are not market conduct actions for purposes of this chapter.

(7) "Market conduct surveillance personnel" means those individuals employed or contracted by the commissioner to collect, analyze, review, or act on information on the insurance marketplace that identifies patterns or practices of insurers.

(8) "National association of insurance commissioners" (NAIC) has the same meaning as in RCW 48.02.140.

(9) "NAIC market regulation handbook" means the outline of the elements and objectives of market analysis developed and adopted by the NAIC, and the process by which states can establish and implement market analysis programs, and the set of guidelines developed and adopted by the NAIC that documents established practices to be used by market conduct surveillance personnel in developing and executing an examination, or a successor product.

(10) "NAIC market conduct uniform examination procedures" means the set of guidelines developed and adopted by the NAIC designed to be used by market conduct surveillance personnel in conducting an examination, or a successor product.

(11) "NAIC standard data request" means the set of field names and descriptions developed and adopted by the NAIC for use by market conduct surveillance personnel in a market conduct examination or other market conduct actions, or a successor product.

(12) "Qualified contract examiner" means a person under contract to the commissioner, who is qualified by education, experience, and, where applicable, professional designations, to perform market conduct actions.

(13) (a) "Market Conduct Examination" means the examination of the insurance operations of an insurer licensed to do business in this state and entities operating illegally in this state, in order to evaluate compliance with the applicable laws and regulations of this state. A market conduct examination may be either a comprehensive examination or a targeted examination. A market conduct examination is separate and distinct from a financial examination of any insurer performed pursuant to chapters 48.03, 48.44, or 48.46 RCW, but may be conducted at the same time.

(b) "Comprehensive Market Conduct Examination" means a review of one or more lines of business of an insurer. The term includes a

review of rating, tier classification, underwriting, policyholder service, claims, marketing and sales, producer licensing, complaint handling practices, or compliance procedures and policies.

(c) "Targeted examination" means a focused examination, based on the results of market analysis indicating the need to review either a specific line or lines of business, or specific business practices, including but not limited to: (a) Underwriting and rating; (b) marketing and sales; (c) complaint handling; (d) operations and management; (e) advertising; (f) licensing; (g) policyholder services; (h) nonforfeitures; (i) claims handling; or (j) policy forms and filings. A targeted examination may be conducted by desk examination or by an on-site examination.

(i) "Desk examination" means a targeted examination that is conducted by an examiner at a location other than the insurer's premises. A desk examination is usually performed at the commissioner's offices with the insurer providing requested documents by hard copy, microfiche, discs, or other electronic media, for review.

(ii) "On-site examination" means a targeted examination conducted at the insurer's home office or the location where the records under review are stored.

(14) "Third-party model or product" means a model or product provided by an entity separate from and not under direct or indirect corporate control of the insurer using the model or product. [DRAFTING NOTE: This definition is necessary for implementation of Sec. 8(2) and addressed industry attempts to deny examiner access.]

(15) "Insurance compliance self-evaluative audit" means a voluntary, internal evaluation, review, assessment, audit, or investigation for the purpose of identifying or preventing noncompliance with, or promoting compliance with laws, regulations, orders, or industry or professional standards, which is conducted by or on behalf of a company licensed or regulated under the insurance laws of this state, or which involves an activity regulated under this title.

(16) "Insurance compliance self-evaluative audit document" means documents prepared as a result of or in connection with an insurance compliance audit. An insurance compliance self-evaluative audit document may include:

(a) A written response to the findings of an insurance compliance self-evaluative audit;

(b) Any supporting information that is collected or developed for the primary purpose and in the course of an insurance compliance self-evaluative audit, including but not limited to field notes and records of observations, findings, opinions, suggestions, conclusions, drafts, memoranda, drawings, photographs, exhibits, computer generated or electronically recorded information, phone records, maps, charts, graphs, and surveys;

(c) Any of the following:

(i) An insurance compliance self-evaluative audit report prepared by an auditor, who may be an employee of the company or an independent contractor, which may include the scope of the audit, the information gained in the audit, conclusions, and recommendations, with exhibits and appendices;

(ii) Memoranda and documents analyzing portions or all of the insurance compliance self-evaluative audit report and discussing potential implementation issues;

(iii) An implementation plan that addresses correcting past noncompliance, improving current compliance, and preventing future noncompliance; or

(iv) Analytic data generated in the course of conducting the insurance compliance self-evaluative audit.

NEW SECTION. Sec. 5. MARKET ANALYSIS PROCEDURES. (1)(a) The commissioner shall collect and report market data information to the NAIC's market information systems, including the complaint data base system, the examination tracking system, the regulatory retrieval system, other successor systems, or to additional systems as the commissioner determines is necessary for market analysis.

(b) Market data and information that is collected and maintained by the commissioner shall be compiled and submitted in a manner that meets the requirements of the NAIC and its systems.

(2) (a) Each entity subject to the provisions of this chapter shall file a market conduct annual statement, in the general form and context, in the time frame required by, and according to instructions provided by the NAIC, for each line of business written in the state of Washington. If a particular line of business does not have an

approved market conduct annual statement form, the company is not required to file a report for that line of business until such time as the NAIC adopts an annual statement form for that line of business.

(b) The commissioner may, for good cause, grant an extension of time for filing a market conduct annual statement, if written application for extension is received at least five business days before the filing due date. Any insurer that fails to file its market conduct annual statement when due or by the end of any extension of time for filing, which the commissioner, in his/her sole discretion, may have granted, shall be subject to the penalty and enforcement provision applicable to the insurer as found in the Washington Insurance Code.

(3)(a) The commissioner shall gather information from data currently available to the commissioner, surveys, required reports, information collected by the NAIC, other sources in both the public or private sectors, and information from within and outside the insurance industry. The commissioner may request insurers to submit data and information that is necessary to conduct market analysis.

(b) The information shall be analyzed in order to develop a baseline understanding of the marketplace and to identify for further review insurers or practices that deviate significantly from the norm or that may pose a potential risk to the insurance consumer. The commissioner shall use the NAIC market analysis handbook as one resource in performing this analysis.

(4)(a) If the commissioner determines, as a result of market analysis, that further inquiry into a particular insurer or practice is needed, the following continuum of market actions shall be considered before conducting a market conduct examination. The commissioner shall not be required to follow the exact sequence of market conduct actions in the continuum or to use all actions in the continuum prior to selecting the appropriate action in the specific circumstance. The action selected shall be made known to the insurer, in writing, if the action involves insurer participation or response.

These actions may include, but are not limited to:

- (i) Correspondence with the insurer;
- (ii) Insurer interviews;
- (iii) Information gathering;
- (iv) Policy and procedure reviews;

(v) Interrogatories;

(vi) Review of insurer self-evaluation and compliance programs. This may include consideration of the insurer's membership in a best practices organization, if the commissioner is satisfied that the organization's qualification process is likely to provide reasonable assurance of compliance with pertinent insurance laws;

(vii) Desk examinations; and

(viii) Investigations.

(b) Except in extraordinary circumstances, the commissioner shall select the least intrusive and most cost-effective market conduct action that the commissioner determines will provide the necessary protections for consumers.

(5) The commissioner shall take those steps reasonably necessary to eliminate duplicative inquiries and coordinate market conduct actions and findings with other state insurance regulators.

(6) For purposes of conducting an examination or other market conduct action on an insurer, the commissioner may examine or conduct a market conduct action on any managing general agent or other person, insofar as that examination or market conduct action is, in the sole discretion of the commissioner, necessary or material to the examination or market conduct action of the insurer.

NEW SECTION. **Sec. 6. PROTOCOLS FOR MARKET CONDUCT ACTIONS.** (1) Market conduct actions shall be taken as a result of market analysis and shall focus on the general business practices and compliance activities of insurers, rather than identifying obviously infrequent or unintentional random errors that do not cause significant consumer harm.

(2)(a) The commissioner is authorized to determine the frequency and timing of such market conduct actions. The timing shall depend upon the specific market conduct action to be initiated, unless extraordinary circumstances indicating a risk to consumers require immediate action.

(b) If the commissioner has information that more than one insurer is engaged in common practices that may violate statutes or rules, the commissioner may schedule and coordinate multiple examinations simultaneously.

(3) The insurer shall be given a reasonable opportunity to

resolve matters that arise as a result of a market analysis to the satisfaction of the commissioner before any additional market conduct actions are taken against the insurer.

(4) The commissioner shall adopt by regulation procedures and documents that are substantially similar to the NAIC work products defined or referenced in this chapter. Market analysis, market conduct actions, and market conduct examinations shall be performed in accordance with such regulation. For any change made to an NAIC work product referenced in this chapter that materially changes the way in which market analysis, market conduct actions, or market conduct examinations are conducted, the commissioner shall give notice and provide parties with an opportunity for a public hearing under chapter 34.05 RCW before such amendment is incorporated into the regulation. If no hearing is held, the commissioner shall use the version of such work product most recently developed and adopted by the NAIC.

NEW SECTION. Sec. 7. ON-SITE MARKET CONDUCT EXAMINATIONS. (1)

When the commissioner determines that other market conduct actions identified in section 5(4)(a) of this act have not sufficiently addressed issues raised concerning company activities in Washington state, the commissioner has the discretion to conduct on-site market conduct examinations in accordance with the NAIC market conduct uniform examination procedures and the NAIC market regulation handbook. RCW 48.03.010 shall not apply to market conduct examinations insofar as that statute requires periodic or regular examinations. However, in all other respects, chapter 48.03 RCW shall apply to market conduct examinations.

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(2)(a) In lieu of an examination of a foreign or alien insurer licensed in this state, the commissioner may accept an examination report of another state provided that the state has laws substantially similar to those of this state and a market surveillance system that the commissioner deems comparable to the market conduct surveillance system set forth in this law.

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(b) The commissioner's determination under subsection (2)(a) is discretionary with the commissioner and is not subject to appeal.

(c) If the insurer to be examined is part of an insurance holding company system, the commissioner may also seek to simultaneously examine any affiliates of the insurer under common control and

management which are licensed to write the same lines of business in this state.

(3) Before commencement of a market conduct examination, market conduct surveillance personnel shall prepare a work plan consisting of the following:

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(a) The name and address of the insurer being examined;

(b) The name and contact information of the examiner-in-charge;

(c) The justification for the examination;

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(d) The scope of the examination;

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(e) The date the examination is scheduled to begin;

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(f) Notice of any noninsurance department personnel who will assist in the examination;

(g) A time estimate for the on-site examination;

(h) A budget for the on-site examination if the cost of the examination is billed to the insurer; and

(i) An identification of factors that will be included in the billing if the cost of the examination is billed to the insurer.

(4) Market conduct examinations shall, to the extent feasible, use desk examinations and data requests before an on-site examination.

(5) Market conduct examinations shall be conducted in accordance with the provisions set forth in the NAIC market regulation handbook and the NAIC market conduct uniform examinations procedures, subject to the precedence of the provisions of chapter 48.03 RCW.

(6) The commissioner shall use the NAIC standard data request.

(7) Announcement of the examination shall be sent to the insurer and posted on the NAIC's examination tracking system, as soon as possible but in no case later than sixty days before the estimated commencement of the on-site examination, except where the exam is conducted in response to extraordinary circumstances as described in section 6(2)(a) of this act. The announcement sent to the insurer shall contain the examination work plan and a request for the insurer to name its examination coordinator.

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(8) If an examination is expanded significantly beyond the original reasons provided to the insurer in the notice of the examination required by subsection 3, the commissioner shall provide written notice to the insurer, explaining the expansion and reasons for the expansion. The commissioner shall provide a revised work plan if the expansion results in significant changes to the items presented

in the original work plan required by subsection 3.

(9) The commissioner shall conduct a preexamination conference with the insurer examination coordinator and key personnel to clarify expectations at least 30 days before commencement of the examination, unless otherwise agreed by the insurer and the commissioner.

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(10) Before the conclusion of the field work for an on-site market conduct examination, the examiner-in-charge shall review examination findings to date with insurer personnel and schedule an exit conference with the insurer, in accordance with procedures in the NAIC market regulation handbook.

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(11)(a) The commissioner shall adhere to the requirements of chapter 48.03 RCW concerning issuance of market conduct examination reports.

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(b) The insurer's response shall be included in the commissioner's order adopting the final report as an exhibit to the order. The insurer is not obligated to submit a response.

(12)(a) The reasonable and necessary costs of a market conduct examination may be assessed against the insurer under examination. The fees shall be consistent with that otherwise authorized by RCW 48.03.060. The fees shall be itemized and bills shall be provided to the insurer on a monthly basis for review prior to submission for payment, or as otherwise provided by state law.

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(b) The commissioner shall maintain active management and oversight of examination costs, including costs associated with the commissioner's own examiners, and with retaining qualified contract examiners necessary to perform an on-site examination. Any agreement with a contract examiner shall:

(i) Clearly identify the types of functions to be subject to outsourcing;

(ii) Provide specific timelines for completion of the outsourced review;

(iii) Require disclosure to the insurer of contract examiners' recommendations;

(iv) Establish and use a dispute resolution or arbitration mechanism to resolve conflicts with insurers regarding examination fees; and

(v) Require disclosure of the terms of the contracts with the outside consultants that will be used, specifically the fees and/or

hourly rates that can be charged.

(c) The commissioner, or the commissioner's designee, shall review and affirmatively endorse detailed billings from the qualified contract examiner before the detailed billings are sent to the insurer.

(d) The commissioner may contract, in accordance with applicable state contracting procedures, for such qualified contract actuaries and examiners as the commissioner deems necessary for the efficient conduct of a particular examination. The compensation and per diem allowances paid to such contract persons shall be reasonable in the market and time incurred.

NEW SECTION. **Sec. 8. ACCESS TO RECORDS AND INFORMATION.** (1)

Except as otherwise provided by law, market conduct surveillance personnel shall have free, convenient, and full access to all books, records, employees, officers, and directors, as practicable, of the insurer during regular business hours.

(2) An insurer using a third-party model or product for any of the activities under examination shall cause, upon the request of market conduct surveillance personnel, the details of such models or products to be made available to such personnel.

(3) Each officer, director, employee, and agent of an insurer shall facilitate and aid in a market conduct action or examination.

(4) No waiver of any applicable privilege or claim of confidentiality in the documents, materials, or information shall occur as a result of disclosure to the commissioner, any employee of OIC, or any agent retained by the OIC to assist in the market conduct examination under this chapter.

(5) When approved by the commissioner pursuant to RCW 48.03.070, market conduct surveillance personnel shall be authorized to issue subpoenas and examine insurance company personnel under oath.

(6) Notwithstanding the provisions of subsection (1) of this section, in order to assist in the performance of the commissioner's duties, the commissioner may:

(a) Share documents, materials, or other information, including the confidential and privileged documents, materials, or information subject to subsection (1) of this section, with other state, federal, and international regulatory agencies and law enforcement authorities,

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and the NAIC and its affiliates and subsidiaries, provided that the recipient agrees to and asserts that it has the legal authority to maintain the confidentiality and privileged status of the document, material, communication, or other information;

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(b) Receive documents, materials, communications, or information, including otherwise confidential and privileged documents, materials, or information, from the NAIC and its affiliates or subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material, or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material, or information; and

(c) Enter into agreements governing the sharing and use of information consistent with this subsection.

[NOTE: Interested parties agreed to suggest a definition of international regulatory agencies and law enforcement authorities.]

NEW SECTION. **Sec. 9. CONFIDENTIALITY.** (1) All data and documents, including but not limited to working papers, third-party models or products, complaint logs, and copies thereof, created, produced, or obtained by or disclosed to the commissioner, the commissioner's authorized representative, or an examiner appointed by the commissioner in the course of any market conduct actions or examinations made under this chapter, or in the course of market analysis by the commissioner of the market conditions of an insurer, or obtained by the NAIC as a result of any of the provisions of this chapter, shall be confidential by law and privileged, shall not be subject to the provisions of chapters 42.17 and 42.56 RCW, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action.

(2) If the commissioner elects to issue a report of an examination, a preliminary or draft market conduct examination report is confidential and not subject to disclosure by the commissioner nor is it subject to subpoena or discovery. This subsection does not limit the commissioner's authority to use a preliminary or draft market conduct examination report and related information in furtherance of any legal or regulatory action, or to release it in

accordance with the provisions of RCW 48.02.065.

(3) An insurance compliance self-evaluative audit document that has been provided to the commissioner is confidential by law and privileged, shall not be:

- (a) Made public by the commissioner;
- (b) Subject to the provisions of chapters 42.17 and 42.56 RCW;
- (c) Subject to subpoena; and
- (d) Subject to discovery and admissible in evidence in any private civil action.

(4) The disclosure of any self-evaluative audit document to the commissioner or the commissioner's designee shall not constitute a waiver of any privilege that may otherwise apply.

NEW SECTION. **Sec. 10.** MARKET CONDUCT SURVEILLANCE PERSONNEL.

(1) Market conduct surveillance personnel shall be qualified by education, experience, and, where applicable, professional designations. The commissioner may supplement the in-house market conduct surveillance staff with qualified outside professional assistance if the commissioner determines that the assistance is necessary.

(2) Market conduct surveillance personnel have a conflict of interest, either directly or indirectly, if they are affiliated with the management, and have, within five years of any market conduct action, been employed by, or own a pecuniary interest in the insurer, subject to any examination under this chapter. This section shall not be construed to automatically preclude an individual from being:

- (a) A policyholder or claimant under an insurance policy;
- (b) A grantee of a mortgage or similar instrument on the individual's residence from a regulated entity, if done under customary terms and in the ordinary course of business;
- (c) An investment owner in shares of regulated diversified investment companies; or
- (d) A settlor or beneficiary of a "blind trust" into which any otherwise permissible holdings have been placed.

NEW SECTION. **Sec. 11.** IMMUNITY FOR MARKET CONDUCT SURVEILLANCE PERSONNEL. (1) No cause of action shall arise, nor shall any liability be imposed against the commissioner, the commissioner's

authorized representatives, market conduct surveillance personnel, or an examiner appointed by the commissioner for any statements made, or conduct performed in good faith while carrying out the provisions of this chapter.

(2) No cause of action shall arise, nor shall any liability be imposed against any person for the act of communicating or delivering information or data to the commissioner or the commissioner's authorized representative, market conduct surveillance personnel, or examiner under an examination made under this chapter, if the act of communication or delivery was performed in good faith and without fraudulent intent or the intent to deceive.

(3) A person identified in subsection (1) of this section is entitled to an award of attorneys' fees and costs if he or she is the prevailing party in a civil cause of action for libel, slander, or any other relevant tort arising out of activities in carrying out the provisions of this chapter, and the party bringing the action was not substantially justified in doing so. For purposes of this section, a proceeding is "substantially justified" if it had a reasonable basis in law or fact at the time that it was initiated.

(4) This section does not abrogate or modify in any way any common law or statutory privilege or immunity before the effective date of this act enjoyed by any person identified in subsection (1) of this section.

NEW SECTION. **Sec. 12.** **FINES AND PENALTIES.** (1) Fines and penalties levied as a result of a market conduct action or examination shall be consistent, reasonable, and justified.

(2) The commissioner shall take into consideration actions taken by insurers to maintain membership in, and comply with the standards of, best practices organizations, and the extent to which insurers maintain regulatory compliance programs to self-assess, self-report, and remediate problems detected, and may include those considerations in determining the appropriate fines or penalties levied in accordance with subsection (1) of this section.

NEW SECTION. **Sec. 13.** **COORDINATION WITH OTHER STATE INSURANCE REGULATORS THROUGH THE NAIC.** (1) The commissioner shall share information and coordinate the commissioner's market analysis, market

conduct actions, and examination efforts with other state insurance regulators. Such matters will be coordinated in accordance with guidelines adopted by the NAIC.

(2) If a market conduct examination or action performed by another state insurance regulator results in a finding that an insurer should modify a specific practice or procedure, the commissioner may, in lieu of conducting a market conduct action or examination, accept verification that the insurer made a similar modification in this state.

NEW SECTION. **Sec. 14. ADDITIONAL DUTIES OF THE COMMISSIONER.** The commissioner shall designate a specific person or persons within the commissioner's office whose responsibilities shall include the receipt of information from employees of insurers and licensed entities concerning violations of laws, rules, or regulations by employers, as defined in this chapter. These persons shall be provided with proper training on the handling of such information. The information shall be confidential and not open to public inspection.

NEW SECTION. **SEC. 15. STUDY AND REPORT.** Not later than December 15, 2012, the commissioner will report to the legislature the results of his study of the provisions of Title 48 RCW which are duplicative of the provisions of this act or which are no longer necessary because of the provision of this act. The commissioner's report shall include a recommendation for resolving duplicative or unnecessary provisions.

NEW SECTION. **Sec. 16. EFFECTIVE DATE.** This act takes effect July 1, 2007.

NEW SECTION. **Sec. 17. CAPTIONS NOT LAW.** Captions used in this chapter are not any part of the law.

NEW SECTION. **Sec. 18.** Sections 1 through 16 of this act constitute a new chapter in Title 48 RCW.